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No. 259

In the Supreme Court of the United States

October Term, 1962

THE [illegible] UNION CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

[illegible]

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 239

THE FARMERS UNION CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 254-295) are not officially reported. The opinion of the Court of Appeals (Pet. App. i-vii) is reported at 300 F. 2d 197.

JURISDICTION

The judgment of the Court of Appeals was entered on March 8, 1962. (Pet. App. viii.) The taxpayer's petition for rehearing was denied on April 10, 1962. The petition for a writ of certiorari was filed on July 9, 1962. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the court below erred in finding that the transaction here involved, under which the taxpayer corporation transferred about two-fifths of its assets to some of its stockholders in exchange for two-fifths of its stock, was a distribution in partial liquidation, on which no gain or loss would be recognized to the taxpayer corporation, rather than a sale of its assets, on which gain or loss would be recognized.

STATUTE AND REGULATIONS INVOLVED

Section 115(i) of the Internal Revenue Code of 1939, and Sections 29.22(a)–15 and 29.22(a)–20 of Treasury Regulations 111, are printed in the Appendix, *infra*, pp. 8–9.

STATEMENT

The facts, set out in the opinion of the Court of Appeals (Pet. App. i–iii, v–vi), may be summarized as follows:

In 1951, the taxpayer corporation operated a retail hardware business and also had substantial real estate holdings in San Jose, California. It wanted to get out of the retail hardware business, and transferred its inventory and related assets to seven of its 134 shareholders, receiving in return 8,000 of its 20,000 shares of stock. Included among these seven were the taxpayer's two controlling shareholders, who, before the transaction owned 75.4 per cent of the taxpayer's stock and after the transaction retained control with 64 per cent. They also controlled the partnership formed to carry on the hardware business.

Since 1945 the taxpayer had been trying to sell its merchandising businesss and restrict itself to operating its real properties. Its president sought out prospective buyers, and there was testimony that there were many offers, none resulting in sale. In 1950 the board of directors proposed dividing the taxpayer into two corporations, with shares in the new corporation distributed on a one-to-one basis to the taxpayer's shareholders. The shareholders approved the plan in November, 1950, but it was dropped. In May, 1951, however, the board adopted a resolution offering to all of the stockholders an opportunity to exchange 8,000 shares of the taxpayer's stock for all of the assets in the merchandising business, subject to designated liabilities. The plan, among other things, provided that the taxpayer would give to the transferees a twenty-year lease on the ground floor of the building where the store was located, at an annual rent of $18,000. The stockholders approved the plan at a special meeting on June 7, 1951, and an escrow agent was designated to receive stock certificates from those who elected to surrender stock under the plan. Most stockholders did not participate, but by October 1, 1951, a group of seven had agreed to do so. The hardware assets were not transferred until the seven had formed a partnership to carry on the merchandising business. On August 16, 1951, the 8,000 shares were in escrow, but had not yet been surrendered to the corporation. On that date, the directors resolved to reduce the taxpayer's stated capital by the amount of the par value of those shares, from $200,000 to $120,000, and

on February 13, 1952, after the shares were surrendered, the stockholders at their annual meeting approved the reduction.

The taxpayer in its tax returns for 1951 treated the transaction as a sale, and claimed a resulting loss of $217,527.20. The Commissioner disallowed the deduction. The Tax Court (R. 287–293) and the Court of Appeals (Pet. App. vi) upheld his decision on the ground that the transaction was a distribution of assets by the corporation in partial liquidation, on which no loss was realized.[1]

ARGUMENT

1. This case turns on whether the transaction is viewed as a sale or a distribution in partial liquidation. For, under applicable Regulations (1939 Code, Reg. 111, § 29.22(a)–20; Appendix, *infra*, p. 9), "No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation * * *."[2] There are no me-

[1] The Commissioner also contended in the Tax Court that the taxpayer had not shown any actual loss, and that, if there was a loss, its deduction was barred by Section 24(b) of the Internal Revenue Code of 1939. The Tax Court and Court of Appeals did not rule on these contentions. The Tax Court also held that, even if there was a loss on the sale in 1951, there could be no carry-over to subsequent years. (R. 280–286.) The Court of Appeals did not reach this question. A subsidiary issue as to the deductibility of certain expenditures was decided by the Court of Appeals in accordance with its decision on the principal issues. (Pet. App. vii.)

[2] The rule that a corporation does not realize gain or loss is not set out in the 1939 Code but is incorporated in the Regulation quoted, and has been approved by this Court. See *General Utilities Co.* v. *Helvering*, 296 U.S. 200, 206. However, in codifying the rule in 1954 (see 1954 Code, § 311(a)(2) and § 336), the Senate Committee on Finance expressly recognized it as the existing law under the *General Utilities* decision

chanical rules for this determination. Whether the transfer of assets by a corporation in return for its own stock is a sale or a distribution in partial liquidation is essentially a factual question. As Section 29.22(a)–15 of Treasury Regulation 111 (1939 Code) (Appendix, *infra*, pp. 8–9) says, the answer "* * * depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. * * *"[3] Heeding the injunction to look behind the form and determine "the real nature of the transaction," the Commissioner concluded that petitioner's transfer of assets amounted to a "partial liquidation" within the statutory definition. 1939 Code, § 115(i) (Appendix, *infra*, p. 8). After thoroughly analysing the evidence, both courts below agreed. Their findings should not lightly be disturbed.

2. The conclusion reached is fully supported by the facts. The circumstances surrounding the transaction refute the contention that the taxpayer was making a "sale" of property or dealing in its shares. There was no arm's length negotiation. As pointed out by the courts below (R. 288–290, Pet. v-vi), there

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and Section 39.22(a)–20 of Regulations 118 under the 1939 Code, corresponding to the similar provision in Treasury Regulations 111. S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 46, 258 (3 U.S. Cong. & Admin. News (1954) 4621, 4677, 4895).

[3] As the court below points out (Pet. App. iv-v), these Regulations accurately state principles long established. See *Commissioner* v. *Boca Ceiga Development Co.*, 66 F. 2d 1004 (C.A. 3d); *Commissioner* v. *S. A. Woods Mach. Co.*, 57 F. 2d 635, 636 (C.A. 1st), certiorari denied, 287 U.S. 613; *Allyne-Zerk Co.* v. *Commissioner*, 83 F. 2d 525, 526 (C.A. 6th); *Golden State T. & R. Corp.* v. *Commissioner*, 125 F. 2d 641, 642 (C.A. 9th); *Dill Manufacturing Co.* v. *Commissioner*, 39 B.T.A. 1023; *Lucius Pitkin, Inc.* v. *Commissioner*, 13 T.C. 547.

was no specific listing of the assets transferred; no amount was stated in the bill of sale as to the value of the stock; and taxpayer failed to comply with the Bulk Sales Act as to recording and notice. Moreover, the offer was limited to stockholders; and it seemed tailored to suit the wish to McEnery, owner of 31 per cent of taxpayer's stock (R. 260) and the most active person in the management of the hardware business (R. 271), to take over that activity (R. 291–292). Nor did the corporation deal in its own shares as it might in the shares of another corporation. McEnery's objective could not have been obtained by dealing in the shares of another corporation (R. 292), and the reduction of stated capital (R. 273) is inconsistent with an intention to deal in the shares turned in (Pet. vi). On the other hand, the facts are consistent with partial liquidation. In addition to the reduction of stated capital and the lack of detail in the listing of assets transferred, we point to the stockholders' resolution and the plan adopted, both of which refer to the transaction in terms signifying a partial liquidation. (R. 289, Pet. v-vi.) Finally, there is the significant fact that the transaction was plainly designed to achieve a contraction of the corporation's business by eliminating a phase of that business.[4]

[4] The significance of this factor is underlined by the Committee Report on the Internal Revenue Code of 1954, which says of the new definition of partial liquidation (§ 346) that, "Primarily, this definition involves the concept of 'corporate contraction' as developed *under existing law* * * *. It is intended that a genuine contraction of the business *as under present law* will result in partial liquidation." S. Rep. No. 1622, 83d Cong., 2d Sess., p. 262 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4899) (Emphasis added).

3. *Dorsey Co.* v. *Commissioner*, 76 F. 2d 339 (C.A. 5th), certiorari denied, 296 U.S. 589, and *Hammond Iron Co.* v. *Commissioner*, 122 F. 2d 4 (C.A. 5th), cited by taxpayer (Pet. 7–8), do not purport to announce a different principle. In each instance, the result turned on the particular facts. One significant fact, present in both those cases and in others holding a sale to have occurred, but absent here, is that common stock was only a part of the consideration transferred to the corporation for its assets.[5]

CONCLUSION

For the reasons stated it is respectfully submitted that the petition for certiorari should be denied.

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[5] *Commissioner* v. *Bedford's Estate*, 325 U.S. 283, also cited by petitioner (Pet. 7), involved an entirely different question—whether cash received as boot in a reorganization was taxable as a dividend or as capital gain.

APPENDIX

Internal Revenue Code of 1939:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * *

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * *

(26 U.S.C. 1952 ed., Sec. 115.)

Treasury Regulations 111 (1939 Code):

SEC. 29.22(a)-15. *Acquisition or Disposition by a Corporation of Its Own Capital Stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as con-

sideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.

* * * * * *

SEC. 29.22(a)–20. *Gross Income of Corporation in Liquidation.*—When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298.) Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition. But see section 44(d) and section 29.44–5.

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